

THE IMPORTANCE OF PRECISION IN ASSESSMENTS

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I

EVER since the days of Adam Smith, the demand for certainty has been one of the cardinal rules in taxation. Adam Smith borrowed his rule from one of the French writers. The arbitrariness of the French system of taxation in the eighteenth century had assumed such proportions as already to pass beyond belief, and it is no wonder that the would-be fiscal reformers raised a loud note of protest against the utter lack of certainty and precision in the French system.

It was not until the French Revolution that the worst evils of the system were swept away; but so fresh has been the recollection of these particular evils that from that day down to the very present, the whole system of French taxation has been so framed as to secure, even at the cost of certain other advantages, the ends of certainty and precision in assessment.

The danger of arbitrariness in assessment can be well illustrated in almost any absolute government. History is replete with examples that may be taken from any Oriental monarchy, and from imperial Rome. Many instances of the most shocking character might easily be taken from the existing absolute governments of the present. But absolutism is, unfortunately, not the only home of arbitrariness in taxation. Strange to say, democracy no less than absolutism is almost equally exposed to this danger. The danger, indeed, assumes a slightly different form. In absolutism there is a lack of law and of constitutional restrictions; in democracy, like that of the United States, for example, which is the classic home of constitutional limitations, the danger lurks not in the law, but in the administration of the law; or rather, the law, which on its face seems to provide

all the constitutional guarantees of fairness and equality, breaks down more or less completely when exposed to the test of practical application under conditions for which it was not originally framed.

It is well known that in a democracy the difficulties of government are primarily administrative rather than constitutional. Our constitutional problems have been, in very large part, satisfactorily solved; our administrative problems have scarcely been attacked. The weakness of democratic administration is proverbial, — and this is especially true in the case of fiscal administration.

Our tax officials are almost uniformly elective officials, and it is a notorious fact that elective officers are but slightly immune to the gusts and passions of popular approval or prejudice. Nothing comes closer to the modern citizen than the amount of sacrifice which he is called upon to make in the way of contributions to the public support, and nowhere is there to be found a greater pressure, whether of individuals or of classes upon the government official than in the case of assessments for taxation. The abuses which in absolutisms are due to the unchecked will of the absolute ruler are found duplicated in democracies, owing to the dependence of the official upon the electorate.

This shortcoming of democratic administration is intensified by the inherent difficulties of modern economic life. In the complex industrial society of the present, with its delicate machinery and its subtle interrelations of all kinds, there is needed a far finer instrument of assessment than in former times. What is perfectly adequate for a primitive community, or a simple agricultural State, becomes glaringly insufficient in the modern industrial environment. Not only are the things themselves to be taxed increasingly difficult of location and appraisal, but the persons upon whom the assessment is levied become, under modern economic conditions, more and more elusive. And yet, just at a time when a more delicate and perfect machinery of assessment is required, modern democracy contents itself with a clumsy and outlived mechanism, which is bound to give dissatisfaction.

Here in the new world we suffer from an accumulation of

evils. Not only is this the home of the greatest experiment in democracy that has ever been attempted, but it is also fast becoming the home of the greatest industrial differentiation and complexity of social and economic organization. Either cause alone would suffice to create difficulties in tax assessments; combined, they form an almost insuperable barrier to success. Mankind has yet to learn the lesson of combining, in fiscal matters at least, the great principles of liberty and efficiency. It is given to but a few countries to attain the administrative efficiency which is found, for instance, in the Prussian government. But that administrative efficiency is purchased at a cost of interference with individual liberty, which would, in this country at least, be considered entirely intolerable. Bureaucracy is not democracy. If, therefore, we eliminate the bureaucratic administration as inapplicable to American conditions, we are still confronted by this question: Which is better, the attempt to posit an ideal in taxation which shall seek to realize the principle of equal justice, even though we know that the endeavor to realize this ideal in practice will inevitably be marred by arbitrariness in administration; or, on the other hand, the readiness to frame a less ideal scheme with the knowledge that in practice it would be attended with greater precision and certainty of operation?

Put in this way, the answer can scarcely be doubtful. What statesmanship is trying to accomplish is not to pose abstract principles, but to accomplish advantageous results. And while the province of the scientist is indeed in part to elucidate fundamental principles, the publicist who is not to remain a mere closet philosopher must always watch closely the working out of his abstract principles amid the hard facts of daily life. Especially true is this of the science of finance, where the border line between finance and administration is found scarcely distinguishable. An ideal principle which is administratively unworkable is not for an instant to be compared with a less elevated ideal which can be actually carried out in practice. The chief trouble with our American democracy in matters of taxation has been that the people have blindly clung to an ideal which has become administratively impracticable; and that they continue to hope against hope in expecting the impossible

to happen. Our administrative methods are indeed slowly improving, but it will be a long time before that point of administrative excellence has been reached which will render possible the realization of the fiscal ideal. In the meantime, the disparity between the ideal and the practice is such as to create in our modern democracy some of the very worst evils of tax assessment which are common in countries without any tax ideals at all.

I do not hesitate to assert that at the present time, in the United States, the chief evils in public finance are to be found primarily in that lack of certainty and precision which were so vehemently emphasized by Adam Smith a century and a half ago. In fact, if we take a broad view of the modern development of taxation, we shall find that one, at least, of the reasons for the great extension of indirect taxation throughout the world is to be found in the fact that here, at least, under the improved modern systems, we are able to attain a certainty and a definiteness which is lacking in the other domains of public revenue. The problem is on a large scale what the choice between *ad valorem* and specific duties is on a small scale. From the point of view of abstract justice there is no doubt that *ad valorem* duties are in the main more equitable, and yet sad experience has taught many a modern nation that there is in *ad valorem* duties such an inherent danger of arbitrariness of administration that they have, perforce, taken refuge, to a very large extent, in a system of specific duties, which is administratively workable, and which contains increased guarantees of certainty and precision.

II

The chief examples of the evils of arbitrary assessments in the United States at present are found in three classes of taxation: the tax on real estate, the tax on personal property and the tax on corporations. Let us say a word as to each.

In the case of real estate, the evils are comparatively insignificant, owing to the fact that real estate is visible and tangible, and that the impediments upon the transfer of real estate have been so far removed in this country as to make real estate almost as easily salable as personal property, and naturally

where sales frequently occur, the selling value becomes a matter either of record or of common knowledge.

Notwithstanding this fact, experience has shown — especially in our larger cities — that the assessment of real estate is very largely arbitrary in character. In some cases the land is held on long leases and sales are infrequent. In other cases a false purchase price is put in the deed, and in still other cases there are sudden changes, either up or down, in the value of the real estate, due to more or less unpredictable changes in business prosperity, in the opening up of new means of communication or in the tides of fashion. As a consequence the real value of real estate becomes a matter of very expert knowledge, and as our tax departments are notoriously unable to secure the services of high-paid experts, the assessment is very largely left in the hands of more or less incompetent underlings. The result has been a system of haphazard assessment, which even with the best intentions, and with all absence of corrupt motive, has meant a decided inequality as between individuals. Where, as frequently occurs, separate parcels within the same city or ward are assessed at all the way from 60 per cent to 90 per cent of their real value, we cannot speak of precision or equality in assessment.

A way out of this difficulty has been indicated by the adoption, in part at least, of certain mathematical rules to guide the assessor. Such schemes as those of Mr. Somers, formerly of Minneapolis, and that in vogue in the city of New York, are familiar to you, and have been explained by the chairman of the Board of Taxes and Assessments in New York City. Without going into the details here, it may be said that the system consists in applying known, instead of unknown, factors to the problem, and in seeking to remove, as far as possible, the arbitrary guess of the assessor.

Of course it must not be forgotten that the opportunity for the introduction of mathematical rules in the assessment of real estate is only a limited one, for at bottom the basic values which are to be multiplied by this mathematical factor must largely remain a matter of individual judgment. In the last instance we cannot get away from the expert decision as to fundamental valuations; but to the extent that known factors

are substituted for unknown factors, a decided improvement is possible, even in the case of real estate.

It is, however, in the case of personal property that the evils of discretionary opinion become far more flagrant. There is no need to repeat before this audience the familiar story of the breakdown of the general property tax; of the failure to ascertain the existence of many kinds of property, and of the shocking inequality of assessment, even where certain kinds of property are discovered. The adoption of mathematical rules of assessment will, of course, not help a whit in those cases where it is impossible to discover anything to be assessed. But in those instances where certain kinds of property are on the assessor's books there is room for considerable improvement by the adoption of more precise and definite rules.

As a good example of what I mean by this statement, take the case of the mortgage tax. The assessment of mortgages as a part of the general property tax has everywhere become notoriously ineffective. The recent adoption of the recording mortgage tax, as in the State of New York, where all mortgages are, so to say, automatically subjected to taxation at the moment of their creation, has brought about, among many other benefits, not only equality as between mortgages, but a decidedly increased revenue to the treasury.

Of a character similar to this is the substitution in some of the Canadian cities of the so-called Business Tax or Rentals Tax, or the recent adoption in one of the Australian States of the so-called "abilities" tax, in lieu of the personal property tax. The imposition of a definite percentage upon the known rentals affords a simple and precise method of reaching property which otherwise would very largely escape notice altogether.

Those who are familiar with the French system of taxation will remember that it is built up entirely on the idea of substituting known for unknown factors, and that while the system has certain disadvantages of its own, in so far as it does not attain the ideal of precise approximation to the exact conditions of the individual, it possesses the inestimable advantage of avoiding the haphazard guesses and arbitrary estimates which are almost inseparable from any democratic administration of personal or individual valuations.

It is, however, in the case of the corporation tax that the problem has become most acute in this country. The well-nigh universal system of taxing corporations is through the medium of the assessment of the corporate property. In some States, as even in the great State of New York, for example, the local tax of corporations which, as almost everywhere, is the one of most importance, is based upon the valuation of the corporate property by local officials. Under this system the most absolute arbitrary discriminations are made, as between the various localities, and it is a notorious fact that those corporations where it is physically possible to do so will often transfer their ostensible chief office from one place to another, in order to secure a more complaisant assessor. In other States, especially for certain classes of public service corporations, the valuation has been put into the hands of a State board, which obviates indeed these glaring discrepancies as between localities, but which does not give any increased assurance of exactness or precision. Even in such cases the abuses are frequent. And what is worst of all, the secrecy observed by the State Board of Assessors renders it utterly impossible for either the victim or the scientific observer to point out the error in the procedure. Especially true is this in all those cases where it has become customary to assess the value of the franchise of corporations, a system which is obviously peculiar to our country, and from which all the European States which base the assessment on income, rather than property value, are entirely exempt. Valuations of our State boards of taxation are so notoriously inadequate that in the case of one class of corporations, namely, railroads, the cry has now gone forth for an official national valuation. Without going into the arguments for and against this scheme, it need only be pointed out that the successful prosecution of this idea will not only cost tens of millions of dollars, but will take a very long time to effect; and that the attempt to apply this same method of national official valuation to all corporations that are subject to taxation would not only be hopelessly expensive, but would, for obvious reasons, be entirely impracticable. In the great mass of cases, if we are to have any valuation of property at all, we shall have to content ourselves with the perpetuation of the present most un-

satisfactory methods. The experiences that we have had, even with the so-called official valuations of railways in Michigan and Wisconsin, are not such as to warrant the confident expectation that they are satisfactory for tax purposes, and that they avoid the evils of arbitrary assessment.

How much better it is to take some external criterion, as is now the practice in a few of our advanced States. In the case of public service corporations a definite percentage of receipts is an obviously simple method. This is not the place to discuss the pros and the contras of a tax on gross receipts *versus* a tax on net receipts; but it may be pointed out that so far as railroads, at all events, are concerned, under the new system of accounting which has been enforced by federal law, the chief objection formerly urged against the tax on net receipts loses almost all its potency. But whether we have a tax on net receipts, or a tax on gross receipts, it is undeniable that the tax is precise and definite; that there is no room for secrecy or arbitrary action, and that equality as between classes of corporations or between individuals in a class, may be secured by the adoption of precise mathematical rules which will cause the rate to vary in accordance with the definite and easily ascertainable factors.

It is true indeed that a few cases have recently been seen of State legislatures abandoning the receipts tax for the system of valuation, but I think that I am safe in saying that expert opinion is almost unanimous in this country, that this was a step backward and not a step forward; and that all the ends which it was attempted to secure by the reintroduction of the valuation system might have been secured by a modification of the rates and methods of the old system. Any method of corporate taxation, in short, which is based upon the application of precise and definite rules, is preferable to the happy-go-lucky system of property valuation, whether it be a tax on gross receipts or on net receipts; whether it be a tax on a certain proportion of the market value of the stocks or of the bonds, or of both together; whether it take some other exterior criterion of the business; any of these methods is susceptible of a more or less successful application because it avoids the fundamental evil in our present system. No one man or set

of men is able to value intelligently and precisely the selling value of the multiplicity of corporations in our modern industrial world, with the continual oscillation of business, and with the increasing complexity of industrial interrelations. The task is one for superhuman strength and ability, and with the weakness of our democratic administrative methods, the attempt would be ludicrous, if it were not so lamentable. The first step in the reform of methods of assessment is, as far as possible, to substitute the known for the unknown.

What the future has in store for us it is given to no man to know. Popular customs and prejudices yield only slowly. The thick mist of ignorance and inertia can be dispelled only very gradually by the sunlight of knowledge and observation. But if the experience of mankind is to afford us any help in fiscal matters, and if the history of other countries under somewhat similar conditions is to be of any aid to us, it may be stated with some reasonable degree of confidence that advance in tax reform is to be sought rather in the progressive excellence of administrative methods than in the elaboration of new and high-sounding ideals. The ideals may be the same for all countries; the administrative methods must differ according to the peculiarities of each. In our American adherence to an abstract ideal we have failed to let our administrative methods keep pace with the attempted realization of the ideal. In our endeavor to secure the taxation of all property, we have not only attempted the impossible, but we have opened wide the door to all the abuses of practical inequality, of unintentional injustice and of widespread arbitrariness.

Of all the methods that cry out most loudly for reform, that of property valuation is the most important. The great need of the day is to replace arbitrariness by certainty, and to secure practical equality in taxation by substituting, as far as possible, definite and fixed rules of assessment for the hodge-podge and capricious system, or lack of system, which is well-nigh universal to-day.

INTERNATIONAL TAX ASSOCIATION

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